



RECENT STATE & LOCAL TAX DEVELOPMENTS AFFECTING WASHINGTON BUSINESSES  
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## B&O Tax Savings for Sellers of Pre-Written Software & Maintenance Agreements

Tucked away within the Washington Excise Tax laws is a small B&O tax provision that became effective July 1, 2004. Though small in size, the potential impact of this provision for companies developing and selling pre-written software is significant. The term “to manufacture” now excludes the production of computer software where no tangible storage media, such as CD’s, hard drives, etc., are transferred to the buyer. For example, software downloaded electronically or delivered on a CD without transfer of the CD to the buyer is

no longer considered a manufacturing activity. Consequently, these activities are not subject to the manufacturing B&O tax. Previously, the Department of Revenue’s position has been that these activities qualified as manufacturing activities and a tax was imposed regardless of where the customer took delivery. Now, wholesaling or retailing B&O tax is imposed on sales delivered in Washington, but interstate sales will not be subject to any B&O tax. Similar rules should apply to ongoing software maintenance agreements as long as the software updates and upgrades are also transmitted electronically. Still unresolved: how to determine where delivery of electronically transmitted software occurs. Stay tuned.

## Changes to High-Tech R&D Credit Cause Higher B&O Taxes. The Good, The Bad, and The Ugly!

Most taxpayers who have been benefiting from the High-Tech R&D credit originally enacted in 1995 are about to see the benefit of the credit decrease due to recent legislative action. The good news is that without this action, the credit would expire on December 31, 2004. The bad news, however, is that the amount of the credit will decrease for most taxpayers. First, only R&D expenses in ex-

cess of the 0.92% floor will be included in the credit calculation rather than all R&D expenses. Second, the credit rate is now based on the average B&O tax rate of the taxpayer rather than a fixed rate of 1.5 percent. For example, taxpayers subject to the manufacturing B&O tax rate will now see their credit rate drop from 1.5 percent to 0.484 percent.

(see “R&D Credit” next page)

## Taxpayers Feel Pain of Automatic 5 Percent Excise Tax Penalty

The Washington State legislature last year amended RCW 82.32.090 to impose a new, 5% penalty on any excise tax billing or assessment. This penalty applies basically to all assessments including those resulting from an audit or notice of balance due. The law states that the penalty can only be waived if the underpayment was the result of circumstances beyond the control of the taxpayer. For now, auditors are toeing the line and impos-

ing the penalty on all audit assessments. Thus, it is more important than ever to avoid and correct existing tax-reporting errors. One reason to correct reporting errors is that the penalty is not imposed when a taxpayer voluntarily pays past-due taxes. When tax assessments do occur, it is equally important to make sure all audit adjustments are valid and that any offsetting credits are included. Browning has assisted many taxpayers by providing pre-audit evaluation and audit defense services that resulted in significant tax, interest, and penalty savings.



**Browning & Associates, P.S.** specializes exclusively in state and local tax (SALT) matters. Its mission is to help clients minimize their overall SALT burden—both above and below the line—and increase the value of their business through improved profitability and cash flow. Some of the services Browning offers clients are listed as follows:

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## DOR Cracks Down on Temp Agencies, Other Companies Deducting Payroll Reimbursements

Any taxpayer presently claiming an exclusion or deduction for payroll reimbursements should exercise extreme caution and be advised that the DOR appears to be focusing on these companies for audit and adding back these deductions for B&O tax purposes. Taking advantage of a recent Washington Supreme Court case, the DOR seems to have decided that only in the rarest of situations will a taxpayer qualify for this deduction. If you are a company that does not subject payroll reimbursements or other third-party reimbursements to B&O tax, we recommend you speak with a Washington tax specialist immediately to evaluate and, if necessary, improve your situation in light of these recent developments.

## High Tech R&D Credit, cont....

And the ugly? New reporting requirements simplify what is reported each month but add significant complexity to what ultimately must be reported the spring of each year. Moreover, the average tax rate calculation may contain an error. The calculation refers to “taxable income” rather than “taxable amount” and if followed exactly could lead to some startling results. The DOR is seeking retroactive corrective legislation next season to fix this problem. A DOR special notice was issued in August to help address some of the changes. Additional guidelines and a revised rule are also in the works at the DOR. We will alert you when this information becomes available.